



BOARD OF EQUALIZATION

BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE DEAN F. ANDAL, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: NOVEMBER 17 & 19, 1999, TIME: 9:30 A.M.

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

**Title: Proposed Regulatory Changes to Clarify Application of Tax on
Property Tax in Lease Agreements (Regulations 1660, 1661, and 1669)**

Issue/Topic:

Should Regulation 1660, *Leases of Tangible Personal Property – In General*, be amended to provide that charges for property tax in lease agreements are not subject to tax, whether assessed directly against the lessee or against the lessor?

Committee Discussion:

Staff provided the background and legislative history of attempts to exclude property tax from taxable lease receipts and recommended that the regulation be amended only to exclude property tax from taxable lease receipts when banks and financial corporations are the lessors. Staff also recommended that Regulations 1661 and 1669 be amended to maintain consistency with Regulation 1660. Mr. Jeff Aran of the California Electric Sign Association addressed the Committee on the issue of both personal and real property tax included in lease receipts of electric signs. Though not part of the discussions with industry on this issue, his organization supports industry's proposed amendment to Regulation 1660.

Committee Action/Recommendation/Direction:

The Committee approved staff's recommendation and directed staff to request authority to publish the amendments to Regulations 1660, 1661 and 1669, which are attached. There is to be no operative date, and implementation will take place upon approval by the Office of Administrative Law.

Agenda Item No: 2

Title: Proposed Amendments to Regulation 1525.2, Manufacturing Equipment

Issue/Topic:

Should Regulation 1525.2, *Manufacturing Equipment*, be amended to: 1) allow claims for refund of the amount of the partial exemption where the partial exemption was not originally claimed in a timely manner and is in lieu of the statutorily authorized refund provisions of Revenue and Taxation Code 6902.2; 2) eliminate the \$250 threshold defining consumable property and provide an option to refute the provisions classifying certain items as consumable that do not qualify for the partial tax exemption; and 3) revise the definition of “establishment” to be based on the definition found in Regulation 1532, *Teleproduction and Other Postproduction Service Equipment*?

Committee Discussion:

Action 1, Claim for Refund

Staff discussed the complimentary system set up with FTB’s Manufacturers’ Investment Credit (MIC) and the Board’s manufacturer’s exemption. Staff explained the availability of the MIC and stressed that allowing claims for refund to be filed would defeat the cash flow benefit objective of the original legislation and create the possibility of taxpayers erroneously claiming both credits.

Action 2, Consumables

Mr. Dave Doerr of the California Taxpayers’ Association and Mr. Chris Micheli of Carpenter, Snodgrass & Associates addressed the Committee in favor of deleting the \$250 threshold. Mr. Doerr also supported Industry 1’s (Manufacturers) proposal for the addition of a rebuttable presumption clause. Staff asserted their position that the \$250 threshold minimizes the burden on retailers and that adding a rebuttable presumption takes away the “bright line” test for both retailers and auditors. It is unclear as to how this provision is affecting manufacturers and retailers.

Action 3, Definition of “Establishment”

Mr. Chris Micheli of Carpenter, Snodgrass & Associates addressed the Committee in favor of using the North American Industry Classification System (NAICS) definition of “establishment” instead of the current Standard Industrial Classification Manual (SIC) definition. He stated that the Legislature passed AB 1040 in 1997. This bill contained an uncodified provision which stated the Legislature’s intent to replace any SIC references that are contained in the Revenue and Taxation Code with the NAICS reference. Staff asserted that the definition used by both FTB and BOE is currently the same and should remain so to avoid confusion.

Committee Action/Recommendation/Direction:Action 1, Claim for Refund

The Committee approved the adoption of Industry 1's (Manufacturers) proposed language, which is attached. Staff confirmed that interest would be included in the amount of the refunds.

Action 2, Consumables

The Committee approved staff and Industry 2's (Retailers) recommendation to make no change to Regulation 1525.2. It was suggested that further study of this area may be warranted.

Action 3, Definition of "Establishment"

The Committee approved staff's recommendation to make no change to Regulation 1525.2 at this time. However, staff was directed to work with FTB staff to further explore the feasibility of this proposal and to determine the status of AB1040.

Action 4, Authorization to Publish

The Committee directed staff to request authority to publish revisions to Regulation 1525.2, which are attached. There is to be no operative date, and implementation will take place upon approval by the Office of Administrative Law.

Agenda Item No: 3**Title: Proposed Notification to Fee Payers Eligible for Refund of Smog Impact Fee****Issue/Topic:**

Should the Board of Equalization (Board) notify persons who have paid the Vehicle Smog Impact Fee (Fee) within the three-year statute of limitations period that they may be entitled to a refund and provide them with a claim for refund form?

Committee Discussion:

Staff recommended that the Committee take no action at this time regarding feepayer notification and provide any assistance requested by the Governor's Task Force. Assemblyman Tom McClintock addressed the Committee on proposed legislation that would refund the Fee to all feepayers without necessitating the filing of a claim for refund, without consideration for the three-year statute of limitations period, and with a provision for interest at the rate applicable to tax underpayments.

Committee Action/Recommendation/Direction:

The Committee directed staff to notify feepayers of their potential refund rights using press releases and by placing information on the Board's web site. The committee directed staff to withhold mailing notification letters and to instead assist Maria Contreras Sweet in the Governor's effort to provide refunds.

Agenda Item No: 4**Title: Proposed Plan for Centralizing Southern California Special Investigations Section Staff in Norwalk****Issue/Topic:**

What is the appropriate Southern California office configuration and staffing for the Investigations Division?

Committee Discussion:

The discussion on November 17, 1999 revolved primarily around the issue of reclassification. An interested party in the issue, California State Employees' Association (CSEA), had no representative present. The Committee had some concern about proceeding without CSEA being present. Additionally, there was some reluctance to proceed due to the existence of a confidential memorandum on the issue, prepared by Mr. Parrish. The proposals contained in the memorandum could not be discussed during this meeting due to the inclusion of confidential personnel matters in the memorandum.

The Committee reconvened on November 19, 1999 to discuss the Investigations classification and organizational issues. A five-point proposal was discussed and voted on a point-by-point basis. The California State Employees Association (CSEA) was represented by Mr. Perry Kenny, CSEA President, and Ms. Sherrie Golden, Chief Legislative Advocate. The Committee adopted the following:

- 1) Authorized staff to advance a pay increase proposal for the Investigative staff (salary differential) to the Department of Personnel Administration (DPA). The proposal provides that:
 - a. there will be no change in the classifications proposed to DPA for the Investigations staff; and
 - b. there will be no change in bargaining unit proposed to DPA for the Investigations staff.
- 2) Directed that there will be no involuntary transfers of the Investigations staff.
- 3) Directed that there will be reasonable reimbursement provided for relocation expenses for those Investigations staff who elect to voluntarily relocate offices and this relocation requires a move.
- 4) Directed Administration to conduct a confidential survey of the Southern California Investigations staff to determine their preference with regard to work location (i.e., Torrance, Riverside and/or Norwalk) and not share those results.
- 5) Upon completion of the survey under Item 4 above, Board staff and DPA will meet and confer with CSEA on the proposal to site the Southern California Investigations offices at Norwalk, Riverside and Torrance until voluntary relocations and attrition allow siting at Norwalk and Riverside. Board staff will report back to the Board after the meet and confer.

Committee Action/Recommendation/Direction:

The following actions were agreed upon as a result of the discussion on November 17, 1999:

- Mr. Parrish will provide his memorandum to the Chief of the Investigations Division on Thursday, November 18, 1999, with the confidential statements removed, requesting comments from Investigations Division's staff.
- The Committee directed the Chief of the Investigations Division to meet with a CSEA representative, who will be requested to prepare a statement outlining their concerns to staff's recommendation.
- Mr. Andal will distribute a brief summary of his position on this issue.
- Discussion of this agenda item will be continued on Friday, November 19, 1999, at 9:30 a.m.

The following actions were agreed upon as a result of the discussion on November 19, 1999:

- Directed staff to implement the above five items.

Approved: /s/ Dean F. Andal
Honorable Dean F. Andal, Committee Chair

/s/ Richard C. Johnson for
E. L. Sorensen, Jr., Executive Director

BOARD APPROVED

at the 11-19-99 Board Meeting

/s/ Janice Masterton
Janice Masterton, Chief
Board Proceedings Division

Regulation 1660. Leases of Tangible Personal Property - In General.

Reference: Sections 6006, 6006.1, 6006.3, 6006.5, 6009, 6010, 6010.1, 6010.65, 6011, 6012, 6012.6, 6016.3, 6092.1, 6094, 6094.1, 6243.1, 6244, 6244.5, 6379, 6390, 6391, 6407, and 6457, Revenue and Taxation Code.

(a) Definitions.

(1) Lease. The term “lease” includes rental, hire, and license. It includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his or her premises, is operated by, or under the direction and control of, the person or his or her employees. “Lease,” however, does not include a use of tangible personal property for a period of less than one day for a charge of less than twenty dollars (\$20) when the privilege to use the property is restricted to use thereof on the premises or at a business location of the grantor of the privilege (see (e) below).

(2) Sale Under a Security Agreement.

(A) Where a contract designated as a lease binds the “lessee” for a fixed term and the “lessee” is to obtain title at the end of the term upon completion of the required payments or has the option to purchase the property for a nominal amount, the contract will be regarded as a sale under a security agreement from its inception and not as a lease. The option price will be regarded as nominal if it does not exceed \$100 or 1 percent of the total contract price, whichever is the lesser amount.

(B) In the case of a contract designated as a lease with any state or local government, the governmental agency designated as a lessee shall be treated as bound for a fixed term notwithstanding any right it may have to terminate the contract to the extent that sufficient funds are not appropriated to pay amounts due under the contract. Such transactions are subject to tax as sales under a security agreement at their inception.

(3) Sale and Leaseback Transactions.

(A) General. Transactions structured as sales and leasebacks will be treated as financing transactions if (1) the “lease” transaction would be regarded as a sale at inception under paragraph (a)(2) of this regulation, (2) the purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for federal or state income tax purposes, and (3) the amount which would be attributable to interest, had the transaction been structured originally as a financing agreement, is not usurious under California law. Transactions treated as financing transactions are not subject to sales or use tax.

(B) Special Application. Transactions structured as sales and leasebacks will also be treated as financing transactions if all of the following requirements are met:

1. The initial purchase price of the property has not been completely paid by the seller-lessee to the equipment vendor.

2. The seller-lessee assigns to the purchaser-lessor all of its right, title and interest in the purchase order and invoice with the equipment vendor.

3. The purchaser-lessor pays the balance of the original purchase obligation to the equipment vendor on behalf of the seller-lessee.

4. The purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for federal or state income tax purposes.

5. The amount which would be attributable to interest, had the transaction been structured originally as a financing agreement, is not usurious under California law.

6. The seller-lessee has an option to purchase the property at the end of the lease term, and the option price is fair market value or less.

(C) Tax Benefit Transactions. Tax does not apply to sale and leaseback transactions entered into in accordance with former Internal Revenue Code Section 168(f)(8), as enacted by the Economic Recovery Tax Act of 1981 (Public Law 97-34).

(D) Acquisition Sale and Leaseback Transactions. No sales or use tax applies to the transfer of title to, or the lease of, tangible personal property pursuant to an acquisition sale and leaseback, which is a transaction satisfying all of the following conditions:

1. The seller/lessee has paid California sales tax reimbursement or use tax with respect to that person's purchase of the property.

2. The acquisition sale and leaseback is consummated within 90 days of the seller/lessee's first functional use of the property (this ninety day period does not begin to run until the first functional use of the property; a period of storage after the purchase but before the first functional use is not used to calculate the 90 day period).

3. The acquisition sale and leaseback transaction is consummated on or after January 1, 1991.

The sale of the property at the end of the lease term is subject to sales or use tax. Any lease of the property by the purchaser/lessor to any person other than the seller/lessee would be subject to use tax measured by rentals payable. A lease to the seller/lessee at the end of the original lease term is subject to use tax measured by rentals payable unless such lease is pursuant to an election to exercise an option to extend the lease term, which option was contained in the original lease agreement.

(b) Leases as Sales or Purchases.

(1) In General. Any lease of tangible personal property in any manner whatsoever for a consideration is a “sale” as defined in section 6006 of the Revenue and Taxation Code, and a “purchase” as defined in section 6010 of the Revenue and Taxation Code, except a lease of:

(A) Motion picture films and video tapes, including television films and video tapes, whether or not they are productions complete in themselves. See, however, subdivision (d)(2) below for application of tax for periods on and after September 1, 1983, to leases of video cassettes, videotapes, and videodiscs for private use under which the lessee or renter does not obtain or acquire the right to license, broadcast, exhibit, or reproduce the video cassette, videotape, or videodisc.

(B) Linen supplies and similar articles, including such items as towels, uniforms, coveralls, shop coats, dust cloths, caps and gowns, etc., when an essential part of the lease is the furnishing of the recurring service of laundering or cleaning of the articles leased.

(C) Household furnishings with a lease of the living quarters in which they are to be used. The lessor of the household furnishings must also be the lessor of the living quarters. The living quarters must be real property rather than tangible personal property.

(D) Mobile transportation equipment for use in transportation of persons or property (see regulation 1661 (18 CCR 1661)).

(E) Tangible personal property leased in substantially the same form as acquired by the lessor or leased in substantially the same form as acquired by a transferor as to which the lessor or his or her transferor acquired the property in a transaction that was a retail sale with respect to which the lessor or the transferor has paid sales tax reimbursement or as to which the lessor or the transferor has timely paid use tax measured by the purchase price of the property.

As used herein, “transferor” means:

1. A person from whom the lessor acquired the property in a transaction described in section 6006.5(b) of the Revenue and Taxation Code, or

2. A decedent from whom the lessor acquired the property by will or by law of succession.

For purposes of 1. above, the transaction will qualify if the property is acquired in a transfer of all or substantially all of the tangible personal property held or used by the transferor in all of his or her activities requiring the holding of a seller’s permit or permits or in an activity or activities not requiring the holding of a seller’s permit or permits, and the ownership of the tangible personal property is substantially similar after the transfer.

(F) Tangible personal property occurring on or after January 1, 1997 described in sections 17053.49 or 23649 of the Revenue and Taxation Code by the manufacturer of that property when leased to a qualified person, as described in sections 17053.49 or 23649 of the Revenue and Taxation Code, in a form not substantially the same as acquired as to which the manufacturer

made a timely election to report and pay tax measured by the cost price of that property as defined in section 6244.5 of the Revenue and Taxation Code and Regulation 1525.3.

(G) A mobilehome, as defined in sections 18008(a) and 18211 of the Health and Safety Code, other than a mobilehome originally sold new prior to July 1, 1980 and not subject to local property taxation.

(2) Leases as Continuing Sales and Purchases. In the case of any lease that is a “sale” and “purchase” under (1) above, the granting of possession by the lessor to the lessee, or to another person at the direction of the lessee, is a continuing sale in this state by the lessor, and the possession of the property by a lessee, or by another person at the direction of the lessee, is a continuing purchase for use in this state by the lessee, as respects any period of time the leased property is situated in this state, irrespective of the time or place of delivery of the property to the lessee or such other persons. The application of tax to such leases is set forth below .

(c) General Application of Tax.

(1) Nature of Tax. In the case of a lease that is a “sale” and “purchase” the tax is measured by the rentals payable. Generally, the applicable tax is a use tax upon the use in this state of the property by the lessee. The lessor must collect the tax from the lessee at the time rentals are paid by the lessee and give him or her a receipt of the kind called for in regulation 1686 (18 CCR 1686). The lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

When the lessee is not subject to use tax (for example, insurance companies), the sales tax applies. The sales tax is upon the lessor and is measured by the rentals payable.

Neither the sales tax nor the use tax applies to leases to the United States and its instrumentalities unless federal law permits taxing the instrumentality. For a more complete explanation regarding sales to the United States and its instrumentalities see Regulation 1614 (18 CCR 1614).

The “rentals” subject to the tax include any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but does not include amounts paid to the lessor for:

(A) Collection costs, including attorney’s fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected by court action;

(B) Insuring, repairing or refurbishing the leased property following a default;

(C) Cost incurred in defending a court action or paying a tort judgment arising out of the lessee’s operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgments;

(D) Cost incurred in disposing of the leased property at expiration or earlier termination of the lease;

(E) Late charges and interest thereon for failing to pay the rentals timely;

(F) Separately stated optional insurance charges, maintenance or warranty contracts.

(G) Personal property taxes assessed against personal property where a bank or financial corporation is the lessor.

(2) **Property Leased in Form Acquired.** No sales or use tax is due with respect to the rentals charged for tangible personal property leased in substantially the same form as acquired by the lessor, or by his or her transferor, as to which the lessor or transferor has paid sales tax reimbursement or has paid use tax measured by the purchase price. If such tax has not been so paid, and the lessor desires to pay tax measured by the purchase price, it must be reported and paid timely with the return of the lessor for the period during which the property is first placed in rental service. A timely return is a return filed within the time prescribed by sections 6452 or 6455 of the Revenue and Taxation Code, whichever is applicable.

(3) **Property Purchased Tax Paid.** In the case of property ultimately leased in substantially the same form as acquired, payment of tax or tax reimbursement measured by the purchase price at the time the property is acquired constituted an irrevocable election not to pay tax measured by rental receipts. The lessor may not change his or her election by reporting tax on rental receipts and claiming a tax-paid-purchase-resold deduction.

(4) **Property Acquired in Exempt Transactions.**

(A) A purchaser of tangible personal property acquired in a transaction defined as an occasional sale in section 6006.5(a) of the Revenue and Taxation Code and leased in substantially the same form as acquired by him or her, may elect to pay use tax measured by the purchase price of the property in lieu of tax measured by rental receipts.

(B) A purchaser of tangible personal property acquired in a transaction which qualifies under section 6006.5(b) of the Revenue and Taxation Code and leased in substantially the same form as acquired by his or her transferor may elect to pay use tax measured by his or her transferor's purchase price of the property in lieu of tax on rental receipts. This provision has application where the transferor did not pay tax or tax reimbursement when he or she acquired the property.

For purposes of this provision, the transaction will qualify if the property is acquired in a transfer of all or substantially all of the tangible personal property held or used by the transferor in all of his or her activities requiring the holding of a seller's permit or permits or in an activity or activities not requiring the holding of a seller's permit or permits and the ownership of the tangible personal property is substantially similar after the transfer (see also (b)(1)(E) above).

(C) The election provided for in (A) and (B) above shall be exercised by the lessor in a timely return filed for the period in which the property is first leased by him or her.

(5) Property Subleased. Tax does not apply to receipts from subleases of tangible personal property which is leased in substantially the same form as acquired by the prime lessor where the prime lessor has paid sales tax reimbursement or use tax measured by his or her purchase price. Also, tax does not apply to subleases of tangible personal property if the tax is paid on rental receipts derived under the prime lease, or any prior sublease.

(6) Use of Property by Lessor. If a lessor, after leasing property and collecting and paying use tax, or paying sales tax, measured by rental receipts, makes any use of the property in this state, other than incidental use, he or she is liable for use tax measured by the purchase price of the property. He or she may, however, apply as a credit against the tax so computed, the amount of tax previously paid to the board with respect to rentals of the property. If the credit is less than the tax, he or she must pay the difference with his or her return, but may apply the amount of such payment against his or her liability for tax on subsequent rentals of the property. Effective January 1, 1973, through December 31, 1978, any amount collected as tax or tax reimbursement by the lessor from the lessee on such subsequent rentals will be regarded as excess tax reimbursement to the extent that the lessor is permitted by the foregoing provisions to apply the amount of his or her payment for use tax against his or her liability for tax on subsequent rentals of the property. An incidental use, e.g., a brief loan of property which otherwise is leased by the lessor pursuant to leases which are continuing sales, subjects the lessor to liability for use tax measured by the fair rental value of the property during the period of the incidental use. (See Regulation 1669.5(b)(7)(18 CCR 1669.5(b)(7)).)

(7) Options to Purchase. An agreement providing for the lease of tangible personal property and granting the lessee an option to purchase the property results in a sale when the option is exercised. The tax applies to the amount required to be paid by the purchaser upon the exercise of the option.

(8) Tax Paid to Another State. A lessor who leases property in substantially the same form as acquired and who has paid a retail sales or use tax, or reimbursement therefor, imposed with respect to that property by any other state, political subdivision thereof or the District of Columbia prior to leasing the property in this state may credit the payment against any use tax imposed on him or her by this state because of such lease. However, to be entitled to the credit the lessor must make a timely election to measure any tax liability for the property by its purchase price, unless the out-of-state tax equals or exceeds the tax imposed on him or her by this state. If the out-of-state tax equals or exceeds the tax imposed on him or her by this state, the lessor will be deemed to have made a timely election and the rental receipts will not be subject to tax provided the property is leased in substantially the same form as acquired. If a timely election is not made, no credit will be allowed because the tax due will be a use tax measured by rental receipts and imposed directly against the lessee, a person other than the one who paid the out-of-state tax or tax reimbursement. If the lessee is not subject to use tax and the lessor does not make a timely election to pay tax measured by his or her purchase price, he or she may not

credit the amount of the out-of-state tax against the tax due on the rental receipts because the tax due is a sales tax rather than a use tax.

A credit otherwise permitted by the foregoing provisions shall not be allowed against taxes which are measured by periodic payments made under a lease, to the extent that taxes imposed by any other state, political subdivision or the District of Columbia were also measured by periodic payments made under a lease prior to the lease of the property in this state.

(9) Assignment of Leases.

(A) In General-Status of Assigned Leases. The situations described in (B), (C), and (D) below involve existing leases which are “sales” and “purchases” subject to tax measured by rental payments. When such a lease is assigned, whether or not title to the leased property is transferred, the rental payments remain subject to tax, without any option to measure tax by the purchase price. An assignee-purchaser who uses the property after termination of the lease is subject to use tax measured by the purchase price as provided in (c)(6) above.

Generally, when an existing lease that is not a “sale” and “purchase” is assigned, whether or not title to the leased property is transferred, the rental payments are not subject to tax. If title is transferred, tax applies measured by the sales price.

For rules relating to the assignment of leases of mobile transportation equipment coming within the exclusions provided in sections 6006(g)(4) and 6010(e)(4) of the Revenue and Taxation Code, see Regulation 1661 (18 CCR 1661).

(B) Assignment of a Right and Creation of a Security Interest. This type of assignment is an assignment by the lessor of the right to receive the rental payments together with the creation of a security interest in the leased property which is designated as such. The assignee has recourse against the assignor.

The assignee in this situation does not have the rights of a lessor and is not obligated to collect or pay the tax measured by the rental payments. The lessor remains subject to the obligation of collecting and reporting the tax even if he or she does not receive the rental payments directly from the lessee. The assignee, however, is obligated to remit to the board any amounts paid to him or her by the lessee as tax.

If the assignee enforces the security agreement and takes title to the property, the assignee as lessor becomes responsible for collecting and reporting the tax.

(C) Assignment of Contract with Transfer of Right, Title, and Interest for Security Purposes. This type of assignment is an assignment by the lessor of the lease contract together with the transfer of the right, title, and interest in the leased property for security purposes. After the termination of the lease, the property usually reverts to the original lessor. The assignment contract may specify that the transfer is for security purposes, or the circumstances may

otherwise demonstrate it (e.g., a separate agreement that the property will be returned to the assignor at the termination of the lease). The assignee has recourse against the assignor.

In this situation, the assignee has assumed the position of a lessor. He or she is required to hold a seller's permit and is obligated to collect, report and pay the tax to the board. The assignor should obtain a resale certificate, covering the property in question, from the assignee.

(D) Assignment of Contract and All Right, Title, and Interest. This type of assignment is an assignment by the lessor of the lease contract together with the transfer of all right, title, and interest in the leased property. The assignment is not for security purposes, and the assignor does not retain any substantial ownership rights in the contract or the property. The assignee has no recourse against the assignor.

In this situation, the assignee has assumed the position of a lessor. He or she is required to hold a seller's permit and is obligated to collect, report and pay the tax to the board. The assignor should obtain a resale certificate, covering the property in question, from the assignee.

(d) Particular Applications.

(1) Chemical Toilets. A lease of a chemical toilet unit is a sale or purchase and tax applies measured by the lease or rental price regardless of whether the unit is leased in substantially the same form as acquired and regardless of whether sales tax reimbursement or use tax has been paid.

(2) Video Cassettes, Videotapes, Videodiscs. On and after September 1, 1983, the rental or lease of a video cassette, videotape, or videodisc for private use under which the lessee or renter does not obtain or acquire the right to license, broadcast, exhibit, or reproduce the video cassette, videotape, or videodisc is a sale or purchase and tax applies measured by rental receipts. Tax applies measured by rental receipts regardless of whether the property is leased in substantially the same form as acquired and regardless of whether sales tax reimbursement or use tax has been paid by the lessor with respect to the purchase price of the video cassette, videotape, or videodisc. If the property was rented, leased or otherwise used prior to September 1, 1983, no refund, credit, or offset for any sales tax reimbursement or use tax paid on the purchase price will be allowed against the tax measured by the lease or rental price after September 1, 1983.

(3) Lease of an Animal. A lease of any form of animal life of a kind the products of which ordinarily constitute food for human consumption is not subject to tax.

(4) Composed Type, Reproduction Proofs, Impressed Mats. Tax does not apply to leases of composed type or reproduction proofs thereof by a typographer to another person for use in the preparation of printed matter or to leases of such reproduction proofs or impressed mats to a printer or publisher for use in printing, except when the reproduction proof is a component part of a "paste-up," "mechanical" or "assembly."

(5) Repair Parts. Sales tax does not apply to sales of repair parts to a lessor which are used by him or her in maintaining the leased equipment pursuant to a mandatory maintenance contract where the rental receipts are subject to tax. Such repair parts are regarded as being part of the sale of the leased item and may be purchased for resale. The amount paid by the lessee under the mandatory maintenance contract is regarded as part of the rental payments.

(6) Neon Signs. A lease of a neon sign that is personal property is subject to the provisions of the Sales and Use Tax Law as any other lease of personal property.

(7) Property Affixed to Realty. For the purpose of this regulation, “tangible personal property” includes any leased fixture affixed to realty if the lessor has the right to remove the fixture upon breach or termination of the lease agreement, unless the lessor of the fixture is also the lessor of the realty to which the fixture is affixed. The term fixture as used herein has the same meaning as the term “fixture” in regulation 1521 (18 CCR 1521).

Leases of structures together with the component parts of such structures, e.g., plumbing fixtures, air conditioners, water heaters, etc., will be treated as leases of real property. Accordingly, tax applies to contracts to construct such structures and the attached components in accordance with regulation 1521 (18 CCR 1521).

On and after September 26, 1989, leases of factory-built school buildings (relocatable classrooms) as defined in paragraph (c)(4)(B) of Regulation 1521 (18 CCR 1521), “Construction Contractors”, will be treated as leases of real property with the lessor to the school or school district as the consumer. If the lessor is the manufacturer, tax applies to the manufacturer’s costs of all tangible personal property used in constructing the factory-built school building. If the lessor is other than the manufacturer, tax applies to 40% of the sales price of the factory-built school buildings to such lessor.

For purposes of this section, “structure” does not include any prefabricated mobile homes or similar items which are registered with the Department of Motor Vehicles. It also does not include a portable building, such as a shed or kiosk, which is moveable as a unit from its site of installation, unless the building is physically attached to the realty, upon a concrete foundation or otherwise. Such a building resting in place by its own weight, whether upon the ground, a concrete slab, or sills or piers, is not a “structure.” A prefabricated or modular building similar in size to, but which is not, a factory-built school building (relocatable classroom) is a “structure” whether the building rests in place by its own weight or is physically attached to realty.

Those fixtures which are essential to the structure such as heating and air conditioning units, sinks, toilets, and faucets, which are leased by the lessor of the structure to which they are attached are considered part of the structure and therefore improvements to real property.

On the other hand, those fixtures which although being a component part of the structure are leased by other than the lessor of the structure, will be considered tangible personal property. Accordingly, the tax consequences with respect to such fixtures will be the same as with respect to any other lease of tangible personal property.

(8) Mobilehomes.

(A) The leasing of any mobilehome purchased by a retailer without payment of sales tax reimbursement or use tax and first leased prior to July 1, 1980, is a continuing sale and tax is due measured by the periodic lease payments unless the mobilehome becomes subject to local property taxation, in which event the lease of the property is thereafter exempt from the sales and use tax.

(B) The lease of a new mobilehome purchased by a retailer without payment of sales tax reimbursement or use tax and first leased on or after July 1, 1980, is excluded from classification as a continuing sale and the lessor's use of such property by leasing is subject to the use tax.

If the use of the property is for occupancy as a residence then the tax is measured by an amount equivalent to 75 percent of the purchase price paid by the lessor's vendor. In the absence of satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of use tax is an amount equivalent to 60 percent of the sales price of the mobilehome to the lessor unless the vendor is also the manufacturer. If such mobilehome is purchased by the lessor from the manufacturer, the measure of the use tax liability is 75 percent of the purchase price of the mobilehome to the lessor.

If the use of the property is not for occupancy as a residence, then the tax is measured by the full retail sales price to the lessor.

(C) The subsequent lease of a used mobilehome which was first sold new in this state after July 1, 1980, is exempt from the sales and use tax.

(e) Grant of Privilege to Use Which is Not a Lease.

(1) In General. Certain restricted grants of a privilege to use property are excluded from the term "lease." To fall within the exclusion, the use must be for a period of less than one continuous 24-hour period, the charge must be less than \$20, and the use of the property must be restricted to use on the premises or at a business location of the grantor of the privilege to use the property.

(2) Definitions.

(A) "Grantor of the privilege" means a person who allows another person to use the personal property.

(B) "Use" includes the possession of, or the exercise of any right or power over personal property by a grantee of a privilege to use the property.

(C) “Premises” or “business location” means a building or specific area owned or leased by a grantor or to which a grantor has an exclusive right of use or a space occupied by the personal property which a grantor allows other persons to use in place. For example:

1. A place in a depot at which a grantor places a coin-operated amusement device pursuant to a contract with the management of the depot.

2. An area in an apartment house or motel where a grantor has a right to place coin-operated washing machines and dryers for use by occupants of the apartment house or motel.

3. A laundromat owned or leased by a person who places therein coin-operated washing machines and dryers for use by customers.

4. A riding stable at which horses are furnished to the public at an hourly rate with a restriction that the horses be ridden within a specific area owned or leased by a grantor of the privilege. The “specific area” might be an enclosed arena or other place the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property.

5. A golf course owned or leased by a golf club which owns or leases golf carts that it furnishes to persons for use in playing the course, or a golf course under the supervision and control of a golf professional who owns or leases golf carts that he or she furnishes to persons for use in playing the course.

(3) Examples of Situations Which Do Not Qualify for Exclusion from the Term “Lease”.

(A) One of several rental firms permitted by a hospital to do so rents a portable television set and stand to a hospital patient for a charge of \$4.00 per day for a period of six days.

This situation does not qualify for the exclusion because the period of “use” is not for less than one day, the total rental is not less than \$20 and the place of use is not the “premises” or “business location” of the rental firm since it does not have “exclusive right of use” of the hospital as regards the placing of its rental units therein nor is the space regularly occupied by it for use in place.

(B) Rental of a canoe for a period of eight hours for a total charge of \$4 when the customer will use the canoe on the Russian River.

This situation does not qualify for the exclusion because the river is not the premises or business location of the grantor of the privilege.

(C) Rental of tools to be used on the premises of the owner of the tools for a period of eight hours invoiced as follows:

1 Portable lamp \$4

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1 Wheel pulley	4
1 Portable hoist	4
1 Sander	4
1 Spray gun	<u>5</u>
Total rental	\$21

This situation does not qualify for the exclusion because the agreement for rental of the property is a single agreement involving rental charges of \$21 and does not meet the requirement that the charge be less than \$20.

(D) An equipment rental firm rents a cement mixer to a customer who takes the mixer to his or her home and uses it for less than one day. The rental charge is \$9. The mixer is of a type which must be firmly “in place” during the cement mixing operation.

This situation does not qualify for the exclusion because although the mixer is firmly “in place” during the mixing operation, it is not in a space regularly occupied by it for use in place by customers of the grantor.

(4) Application of Tax to Situations Qualifying for Exclusion from the Term “Lease”. The grantor of the privilege to use property under the conditions described in (1) above is the consumer of the property. Accordingly, charges by him or her for the privilege to use the property are not subject to tax. Tax applies to the sale of the property to him or her by a retailer or to his or her use of the property, measured by his or her purchase price, when the property is purchased from a retailer in California under a resale certificate or from a retailer at an out-of-state location. If the property is acquired through an “occasional sale” as defined in section 6006.5 of the Revenue and Taxation Code, or other exempt transaction, no tax applies to the acquisition or use of the property by the grantor nor to his or her charges for the privilege to use the property.

History: Amended November 3, 1969, applicable on and after November 10, 1969.
 Amended November 5, 1970, effective December 10, 1970.
 Amended and renumbered November 3, 1971, effective December 3, 1971.
 Amended December 15, 1971, applicable on and after December 15, 1971.
 Amended February 16, 1972, effective March 25, 1972.
 Amended November 15, 1972, effective December 21, 1972.
 Amended June 24, 1976, effective July 30, 1976. In (c)(7) added and defined “incidental use.”
 Amended August 17, 1976, effective September 19, 1976. Noted that sales tax on United States or its instrumentalities is legal only when permitted by federal law.
 Amended August 17, 1976, effective October 23, 1976. Added part of (c)(1) previously deleted in error.
 Amended December 7, 1978, effective January 28, 1979. Deletes language pertaining to excess tax reimbursement; amends subsection (b)(1)(E) which provides when leases of tangible personal property are not considered sales; and

amends subsection (c)(1) to provide that after 1/1/79 leases of tangible personal property to the United States are subject to sales tax.

Amended March 7, 1979, effective May 16, 1979. Altered definition of "lease", operative 1/1/79.

Amended February 6, 1980, effective March 29, 1980. Added Sections 6092.1, 6243.1 and 6381.5 to references. In (c)(1) deleted "state and national banks," and substituted "a federally-chartered bank exempt from direct state taxation under federal law," and added four conditions for exemption from sales tax; in (c)(8) deleted "bank" and substituted "federally-chartered bank exempt from direct state taxation under federal law."; in (c)(9)(A) deleted sentences referring to Section 6094(d) and 6244(d); added final paragraph.

Amended August 1, 1980, effective August 22, 1980, operative July 1, 1980. In (b), added (1)(F); in (d), added (8).

Amended November 19, 1980, effective January 16, 1981. In (d)(8)(B) added provisions regarding manufacturer; added paragraph re measure when property not used as residence.

Amended April 1, 1981, effective August 19, 1981. In (b)(1)(E) deleted requirement that lessors prove that retailer paid tax to the Board; substituted "lessor or the transferor has paid sales tax reimbursement." In (c)(2) added "has paid sales tax reimbursement"; deleted "or their vendor has paid sales tax measured by gross receipts."

Amended October 26, 1983, effective November 17, 1983. Added last sentence to subparagraph (b)(1)(A) and new subparagraph (2) to subdivision (d), and renumbered former subparagraphs (2) through (8) to (3) through (9).

Amended May 9, 1985, effective September 22, 1985. In Subdivision (c)(1), deleted references indicating that sales tax applies to leases to the United States and its tax-exempt instrumentalities. In subdivision (c)(1), added definitions of "rentals subject to tax" and provided for the exclusion of certain other charges by the lessor which are not part of rentals. In subdivision (c)(8), deleted references to the United States and its tax-exempt instrumentalities and added reference to the lessee who is "not subject to use tax".

Amended May 10, 1989, effective July 26, 1989. Amended to include changes necessitated by AB 4417, Chapter 825, Statutes of 1986, and by the holding in *Cedars-Sinai Medical Center v. State Board of Equalization*, 162 Cal.App.3d 1182 (1984). See subdivisions (a)(2)(B) and (a)(3)(A), (B) and (C). Also amended subdivisions (d)(1), (d)(3) and (e) to delete unnecessary language and subdivision (d)(8) to correct a typographical error.

Amended June 5, 1991, effective August 22, 1991. Deleted explanation of the application of tax to leases of certain structures which were entered into prior to 1971. Amended paragraph (b)(1)(F) to limit definition of "mobilehome" for purposes of this regulation to paragraph (a) of Section 18008 and to paragraph 18211, Health and Safety Code. Amended paragraph (d)(8) to delete outdated information and to clarify treatment of leases of factory-built school buildings.

Amended August 1, 1991, effective August 27, 1991. Amended pursuant to Chapter 85, Statutes of 1991, and Chapter 88, Statutes of 1991, to repeal an

exemption from sales and use tax for tax on the sale or use of a photograph when possession but not title of the photograph is transferred for the purpose of being reproduced one time only in a newspaper regularly issued at average intervals not exceeding three months. Subparagraphs of paragraph (d) were renumbered.

Amended May 3, 1994, effective July 30, 1994. Added subdivision (a)(3)(D) to define acquisition sale and leaseback, the period of time the provision will be used, and interprets its application to various post-lease transactions.

Amended June 22, 1995, effective July 22, 1995. Deleted subparagraph (a)(3)(D)4. as provided in Statutes of 1994, Chapter 286.

Amended November 5, 1997, effective December 5, 1997. Added new subdivision (b)(1)(F) to incorporate provisions of Chapter 954, Statutes of 1996, and renumbered the following subdivision.

Regulation 1661. Leases of Mobile Transportation Equipment.

Reference: Sections 6006, 6006.1, 6006.3, 6006.5, 6009, 6010, 6010.1, 6011, 6012, 6016.3, 6023, 6024, 6092.1, 6094, 6243.1, 6244, 6352, 6390, 6391, 6407 and 6457, Revenue and Taxation Code.

(a) Definitions.

(1) “Mobile Transportation Equipment”. The term “mobile transportation equipment” includes only equipment for use in transporting persons or property for substantial distances. The term does not include items of a kind commonly used only in loading or unloading persons or property, or short distance moving within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport. Examples of such items are hand dollies, forklift trucks, mine cars, pilot boats, tugboats and lighters, not including, however, lighters or barges specifically designed to be carried regularly aboard vessels for substantial distances. The term does include pickup trucks and tangible personal property which is or becomes a component part of mobile transportation equipment.

The following items are specifically excluded from the definition of mobile transportation equipment:

(A) Passenger vehicles as defined in section 465 of the California Vehicle Code;

(B) Trailers and baggage containers designed for hauling by passenger vehicles; and

(C) One-way rental trucks. These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, not exceeding the manufacturer’s gross vehicle weight rating of 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short-term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or being employed in this state by the person, are identified to the board by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased and maintaining records which can be verified by audit of the vehicles as to which such an election has been made.

Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and any taxes which are imposed are measured by the rentals. Once a truck is identified to the board as a one-way rental truck, the election may not be revoked with respect to the equipment as to which it is made. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.

(2) “Bogie”. The term “bogie” means a vehicle consisting of an axle or axles with wheels and tires with a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not

required. Bogies may be designed and constructed so as to allow a sliding movement under a container (or van body) to several positions under the container to adjust to desired axle loading.

(3) “Chassis”. The term “chassis” means a frame with one or more axles designed to be used in conjunction with and as a temporary support or undercarriage for a container or other van-type box. The chassis and axle or axles may be designed and constructed so as to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.

(4) “Dolly”. The term “dolly” means a vehicle consisting of a tongue, fifth wheel and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.

When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a “full” trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle or axles equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.

(5) “Ships” The term “ships” includes vessels 30 feet or more in length. The term does not include vessels less than 30 feet in length.

(b) Application of Tax.

(1) With respect to leases of mobile transportation equipment, the sale to the lessor is the retail sale and the lessor is the consumer of the equipment. Accordingly, either the sale of the equipment to the lessor or its use in this state may be subject to tax. For example, if the sale and delivery occur within California, the transaction is subject to sales tax unless the lessor makes a timely election to report his or her tax liability measured by the fair rental value as provided in (b)(2) below. On the other hand, if the sale and delivery occur outside California and the property is purchased for use in California, use tax will apply measured by the purchase price unless the equipment enters the state in interstate commerce and is used continuously thereafter in interstate commerce, or the lessor makes a timely election to report use tax liability measured by the fair rental value as provided in (b)(2) below.

If in connection with an assignment of an existing lease of mobile transportation equipment, title to the leased property is transferred to the assignee, the transfer is a sale to the assignee and the assignee is the consumer of the equipment. Application of tax is governed by the rules set forth in this section (b)(1).

(2) If the use of mobile transportation equipment purchased under a resale certificate is limited to leasing the equipment, the purchaser may elect to pay his or her use tax liability measured by the fair rental value if the election is made on or before the due date of a return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on a timely return for that period. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made. Any separately stated amount collected from a lessee by a lessor electing to report use tax measured by fair rental value under the representation by the lessor that the amount is use tax imposed on the customer must be returned to the customer or paid to the board. A designation by the lessor of a separately stated amount as “use tax”, without further explanation, will be regarded as a representation that the amount is use tax imposed on the customer.

This election is available to any purchaser who leases mobile transportation equipment, other than a person exempt from use tax under Revenue and Taxation Code Section 6352, and such purchaser may properly issue a resale certificate for the limited purpose of reporting use tax liability based on fair rental value.

(A) Fair Rental Value. “Fair rental value” means the rentals required by the lease, except where the Board determines the rental receipts are nominal. Fair rental value does not include any payment made by the lessee to reimburse the lessor for the lessor’s use tax, whether or not the amount is separately stated, and regardless of how the charge is designated in the lease documentation and invoices. Lump-sum charges to the lessee will be assumed to include reimbursement for the lessor’s use tax whether or not any statement to that effect is made to the lessee.

Example:

Assuming a 6 percent tax rate, if the invoice to the lessee states “rental \$100, tax reimbursement to the lessor \$6”, “rental \$100, sales and use taxes \$6”, or similar wording, the fair rental value is \$100. If the invoice to the lessee states “rental \$106” and makes no reference to reimbursement, the fair rental value is \$100 (\$106 divided by 1.06). Assuming a 6.5 percent tax rate, the fair rental value is \$99.53 (\$106 divided by 1.065).

Fair rental value includes any deficiency payment required from the lessee on disposition of mobile transportation equipment at the termination of an open-end lease and such payment is subject to tax. Any surplus rentals, however, which are returned to the lessee at the termination of an open-end lease may be deducted from the total fair rental value reported for the period in which the surplus rentals are returned. In the alternative, a refund may be claimed for any tax paid within the applicable statute of limitations period on such surplus rentals.

Fair rental value includes any capitalized cost reduction payment, which is a one-time payment by the lessee at the start of the lease to reduce the lessor’s investment and the lessee’s rentals. The payment may either be reported for the period in which it became due from the lessee or it may be reported in equal increments over the lease term. On early termination of such a lease,

any unreported portion of the capitalized cost reduction payment shall be reported for the period in which termination occurred.

The term “fair rental value” includes any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but does not include amounts paid to the lessor for:

(1) Collection costs, including attorney’s fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected by court action;

(2) Insuring, repairing or refurbishing the leased property following a default;

(3) Costs incurred in defending a court action or paying a tort judgement arising out of the lessee’s operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgements;

(4) Costs incurred in disposing of the leased property at expiration or earlier termination of the lease.

(5) Late charges and interest thereon for failing to pay the rentals timely;

(6) Separately stated optional insurance charges, maintenance or warranty contracts.

(7) Personal property taxes assessed against personal property where a bank or financial corporation is the lessor.

(B) Tax Application. Tax applies to fair rental value for all periods during which the mobile transportation equipment is leased even though the lessee may not make the required rental payments. The lessor must pay tax at the rate in effect at the time the equipment is first leased. The tax rate will remain the same for all periods during which the equipment is leased, including the periods during the first lease of the equipment and all periods during any subsequent leases of the equipment.

Tax on fair rental value does not apply either (a) for periods during which the equipment is not leased and is merely held for lease; or (b), for periods after the lessor has formally demanded return of the equipment if the lessee wrongfully retains possession of the property and is not required to make rental payments under the lease. If mobile transportation equipment is sold while subject to an existing lease and the new purchaser elects to pay tax measured by fair rental value, the applicable tax rate during the existing lease and during all subsequent leases is the rate in effect at the time of the sale of the mobile transportation equipment to the new purchaser.

Regulation 1669. Demonstration, Display and Use of Property Held for Resale - General.

Reference: Sections 6092.1, 6094, 6243.1, 6244 and 6403, Revenue and Taxation Code.

(a) In General. A purchaser of tangible personal property who gives a resale certificate therefor, and who uses the property solely for demonstration or display while holding it for sale in the regular course of business, is not required to pay tax on account of such use. Except as otherwise provided in this regulation, if the property is used for any purpose other than or in addition to demonstration or display, such as making deliveries, personal use of employees, etc., the purchaser must include in the measure of the tax reported the purchase price of the property. Tax applies to the subsequent retail sale of the property.

(b) Sale to Sales Representatives for Demonstration. Tax applies to sales by dealers to their sales representatives of tangible personal property to be used for demonstration. It is presumed that any such tangible personal property will be used for purposes in addition to demonstration, and any resale certificates given for such property by sales representatives to dealers will be questioned, even if the sales representatives hold seller's permits.

(c) Rental to Sales Representatives for Demonstration. A dealer who rents property to sales representatives is regarded as making a continuous sale of the property and must collect and pay tax on the rental receipts unless tax has been paid measured by the purchase price of the property rented. The dealer must also include in the measure of the tax reported the gross receipts from the retail sale of such property following its rental to the sales representatives.

(d) Loans to Schools for Educational or Training Program. The loan by any retailer of any tangible personal property to any school district for an educational program conducted by the district is exempt from the use tax.

(e) Donations of Property.

(1) In General. Operative January 1, 1989, use tax does not apply to tangible personal property withdrawn from a resale inventory for the purpose of making a charitable contribution to a qualified organization located in this state. This exemption applies only to property which has been purchased for resale and subsequently donated without any use other than retention, demonstration or display while holding it for sale in the regular course of business. For purposes of this regulation, property purchased for the purpose of incorporation into a manufactured article is regarded as having been purchased for resale. For the period January 1, 1989 through October 1, 1989, this exemption is available only to retailers. Effective October 2, 1989, this exemption is available to all sellers.

Property purchased specifically for donation to a qualified organization remains subject to the tax. As provided in section 6094.5 of the Revenue and Taxation Code, a person is guilty of a misdemeanor if a resale certificate is issued for property which he or she knows at the time of purchase will be donated rather than resold. Such improper use of a certificate may cause that person to become liable for penalties called for by Sections 6072, 6094.5, 6484 or 6485 of the Revenue and Taxation Code.

(2) “Qualified Organization”. For purposes of this regulation, “qualified organization” means and includes any organization described in Section 170(b)(1)(A) of the Internal Revenue Code including but not limited to:

- A. religious organizations, e.g., synagogues, churches and associations of churches;
- B. charitable organizations, e.g., the Red Cross, the Salvation Army, nonprofit schools and hospitals, and medical assistance and research groups;
- C. organizations operated for educational, scientific, or literary purposes including nonprofit museums, art galleries, and performing arts groups;
- D. organizations operated for the protection of children or animals;
- E. fraternal lodges if the donated property is to be used for charitable purposes and not for the benefit of the members; and
- F. the United States, this state and any political subdivision of this state.

Effective January 1, 1990, a nonprofit museum will not be considered a “qualified organization” unless the donated property is used exclusively for purposes of display to the public within the museum and the museum either:

- (1) has a significant portion of its display space open to the public without charge during its normal operating hours;
- (2) has its entire display space open to the public without charge for at least six of its normal operating hours during each month of operation; or
- (3) has its entire display space open without charge to a segment of the student or adult population for educational purposes.

(f) Use of Rental Value as a Measure of Tax.

(1) Where Applicable.

(A) Accommodation Loans. If the use of property purchased under a resale certificate is limited to the loan of property to customers as an accommodation while awaiting delivery of property purchased or leased from the lender or while property is being repaired for customers by the lender, the measure of tax is the fair rental value of the property for the duration of each loan so made. The lender must also include in the measure of the tax reported the gross receipts from the retail sales of such property following its loan to customers.

(B) Property Used Both for Demonstration and Other Purposes. If property purchased under a resale certificate is used frequently for purposes of demonstration or display while holding it for sale in the regular course of business and is used partly for other purposes, the measure of tax is the fair rental value of the property for the period of such other use or uses. The gross receipts from the retail sale of the property after such use or uses must be included in the measure of tax.

This applies, for example, to a situation in which a dealer or lessor purchases property without tax paid on the purchase price and uses it personally, or allows sales representatives, sales managers, partners, corporate officers, or other authorized persons to use the property, for purposes in addition to demonstration and display.

The property must, in fact, be used frequently for demonstration or display. Mere incidental use for demonstration or display will not suffice. The dealer or lessor must maintain evidence substantiating the exempt use for examination by board auditors.

(C) Aircraft Dealers. The use of aircraft withdrawn from inventory for flight instruction and personal and business use is subject to tax. Tax may be reported on the fair hourly rental value of such use provided the requirements of (B) above are met.

(D) Mobile Transportation Equipment Leased While Being Held for Resale. If the use of mobile transportation equipment purchased under a resale certificate is limited to leasing the equipment, the purchaser may elect to pay use tax liability measured by the fair rental value if the election is made on or before the due date of a return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on the return for that period. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made.

This election is available to any purchaser who leases mobile transportation equipment, other than a person exempt from use tax under Revenue and Taxation Code Section 6352, and such purchaser may properly issue a resale certificate for the limited purpose of reporting use tax liability based on fair rental value.

1. Fair Rental Value. "Fair rental value" means the rentals required by the lease, except where the Board determines the rental receipts are nominal. Fair rental value does not include any payment made by the lessee to reimburse the lessor for the lessor's use tax, whether or not the amount is separately stated, and regardless of how the charge is designated in the lease documentation and invoices. Lump-sum charges to the lessee will be assumed to include reimbursement for the lessor's use tax whether or not any statement to that effect is made to the lessee.

Example:

Assuming a 6 percent tax rate, if the invoice to the lessee states "rental \$100, tax reimbursement to the lessor \$6", "rental \$100, sales and use taxes \$6", or similar wording, the fair rental value is

\$100. If the invoice to the lessee states “rental \$106” and makes no reference to reimbursement, the fair rental value is \$100 (\$106 divided by 1.06). Assuming a 6.5 percent tax rate, the fair rental value is \$99.53 (\$106 divided by 1.065).

Fair rental value includes any deficiency payment required from the lessee on disposition of mobile transportation equipment at the termination of an open-end lease and such payment is subject to tax. Any surplus rentals, however, which are returned to the lessee at the termination of an open-end lease may be deducted from the total fair rental value reported for the period in which the surplus rentals are returned. In the alternative, a refund may be claimed for any tax paid within the applicable statute of limitations period on such surplus rentals.

Fair rental value includes any capitalized cost reduction payment, which is a one-time payment by the lessee at the start of the lease to reduce the lessor’s investment and the lessee’s rentals. The payment may either be reported for the period in which it became due from the lessee or it may be reported in equal increments over the lease term. On early termination of such a lease, any unreported portion of the capitalized cost reduction payment shall be reported for the period in which termination occurred.

The term “fair rental value” includes any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but does not include amounts paid to the lessor for:

a. Collection costs, including attorney’s fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected in court action;

b. Insuring, repairing or refurbishing the leased property following a default;

c. Cost incurred in defending a court action or paying a tort judgement arising out of the lessee’s operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgements;

d. Cost incurred in disposing of the leased property at expiration or earlier termination of the lease;

e. Late charges and interest thereon for failing to pay the rentals timely;

f. Separately stated optional insurance charges, maintenance or warranty contracts.

g. Personal property taxes assessed against personal property where a bank or financial corporation is the lessor.

2. Tax Application. Tax applies to fair rental value for all periods during which the mobile transportation equipment is leased even though the lessee may not make the required rental payments.

Tax on fair rental value does not apply either (a) for periods during which the equipment is not leased and is merely held for lease; or (b), for periods after the lessor has formally demanded return of the equipment if the lessee wrongfully retains possession of the property and is not required to make rental payments under the lease.

(2) Measuring Fair Rental Value. The fair rental value for property other than mobile transportation equipment is the amount which normally is charged by the lender for the rental of similar property under similar circumstances. If the lender does not rent similar property, the rental rate which generally is charged by others in the area is to be used.

Regulation 1525.2. Manufacturing Equipment.

Reference: Section 6377, Revenue and Taxation Code.

(a) Partial Exemption for Property Purchased for Use in the Manufacturing Process. Section 6377 of the Revenue and Taxation Code provides a partial exemption from sales and use tax for certain properties described in this regulation. For the period commencing on January 1, 1994, and ending on December 31, 1994, the partial exemption applies to the taxes imposed by the state (6%), but does not apply to the taxes imposed by counties, cities, and districts pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200, et seq.) or the Transactions and Use Tax Law (Rev. & Tax. Code §§ 7251, et seq.). Commencing on January 1, 1995, the partial exemption applies to the taxes imposed by sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (5%), but does not apply to the taxes imposed pursuant to sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or section 35 of article XIII of the California Constitution.

Subject to the limitations set forth above, this partial exemption applies to gross receipts from the sale, storage, use, or other consumption in this state of the following items:

(1) Tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point that raw materials are received by the qualified person and introduced into the process and ending at the point at which the property has been altered to its completed form, including packaging, if required. For purposes of this regulation:

(A) Raw materials will be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing activities are conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing activities are conducted, however, will not be considered to have been introduced into the process for purposes of this regulation.

(B) For purposes of this regulation, the term "packaging" includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare the goods so that they are suitable for delivery to and placement in finished goods inventory. Any additional packaging, such as that packaging necessary to consolidate the goods prior to shipping or to protect them during transportation, shall not be considered to be "packaging" for purposes of this regulation.

(2) Tangible personal property purchased for use by a qualified person to be used primarily in research and development as defined in subsection (c)(8).

(3) Tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any property described in subsections (a)(1) or (a)(2).

(4) Tangible personal property purchased for use by a contractor purchasing that property either as an agent of a qualified person or for the contractor's own account and subsequent resale to a qualified person for use in the performance of a construction contract for the qualified person

who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with the manufacturing process.

(b) Property Used Primarily in Administration, General Management, or Marketing. Notwithstanding any other provision of this regulation, this partial exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing. For purposes of this subsection:

(1) Tangible personal property is used primarily in administration, general management, or marketing when it is used 50 percent or more of the time in one or more of those activities.

(2) Tangible personal property used primarily to clean and maintain the factory floor of a manufacturing facility is used primarily in a stage of the manufacturing of property and is not used primarily in administration, general management, or marketing.

(3) Fire safety equipment that is tangible personal property and that is used primarily at and in connection with the factory floor of a manufacturing facility is used primarily in a stage of the manufacturing of property and is not used primarily in administration, general management, or marketing.

(c) Definitions. For purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. For purposes of this regulation, "greater functionality" means that the tangible personal property has been improved so that it can perform new or different functions than the original property. Manufacturing includes logging, that is, the felling of timber, but does not include tree farming. Manufacturing does not include crop harvesting. Provided that the activity constitutes a "sale" as that term is used in subdivision (b) of section 6006 of the Revenue and Taxation Code, the tangible personal property need not be owned by the qualified person in order for the activity to qualify as manufacturing for purposes of this regulation.

(3) "Primarily" means that the tangible personal property is used 50 percent or more of the time in the designated activity or activities.

(4) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and are introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are

stored on the same premises where the qualified person's manufacturing, process, refining, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(5) "Processing" means the physical application of materials and labor to modify or change the characteristics of property.

(6) "Qualified person" means any person that satisfies the requirements of both subsections (c)(6)(A) and (c)(6)(B) below with regard to the trade or business in which the property will be placed into service in the use qualifying the property for this partial exemption:

(A) A "qualified person" must have first commenced trade or business activities in a new trade or business in this state on or after January 1, 1994. For purposes of this subsection, the term "activities" means trade or business activities. In determining whether or not a person is qualified within the meaning of this subsection, the following rules apply:

1. The term "trade or business activities" does not mean the mere formation or organization of a corporation or other business entity that is intended to conduct a trade or business. Instead, a corporation or business entity first conducts activities when it first starts or commences the trade or business for which it was organized. The acquisition of operating assets that are necessary to the type of business contemplated, however, will constitute commencing activities. The term "operating assets" as used in this subsection means assets that are in a state of readiness to be placed in service within a reasonable time period following their acquisition.

2. Notwithstanding any other provision of this subsection, a person will not be considered to have first commenced activities in a new trade or business in this state on or after January 1, 1994, if, at any time within the 36 months preceding that date, that person, or any related person, was required to have secured a seller's permit under section 6066 of the Revenue and Taxation Code for that trade or business, or any other trade or business classified under the same division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition (the "Manual"). For purposes of this regulation, the term "division" means a division as that term is used in the Manual.

3. A trade or business is not a new trade or business in this state if, within the 36 months preceding the date that activities were first commenced in that trade or business in this state, either the person claiming the partial exemption, or any related person, had conducted any activities in this state in any trade or business classified under the same division of the Manual as that trade or business.

4. Where a person, or any related person, is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (a "prior trade or business activity"), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new trade or business if the additional trade or business activity is classified under a different division of the Manual than are any of the person's (or any related person's) current or prior trade or business activities in this state within the preceding 36 months.

5. Where a person, including all related persons, is engaged in trade or business activities wholly outside of this state and that person first commences doing business in this state (within the meaning of section 23101 of the Revenue and Taxation Code) after December 31, 1993 (other than by purchase or other acquisition described in subsection (c)(6)(A)6.), the newly commenced trade or business activity in this state shall be treated as a new trade or business for purposes of this subsection.

6. On or after January 1, 1995, notwithstanding anything else set forth in this subsection, in any case where a person purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of the entity) that is doing business in this state (within the meaning of section 23101 of the Revenue and Taxation Code), the trade or business thereafter conducted by that person (or any related person) shall not be treated as a new trade or business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by that person (or any related person) in the conduct of his or her trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the person (or any related person) being used in the same trade or business both within and without this state. For purposes of this subsection only:

a. The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the month following the quarterly period in which the person (or any related person) first uses any of the acquired trade or business assets in his or her business activity.

b. Any acquired assets that constitute property described in section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in section 1221(1) of the Internal Revenue Code in the hands of the acquiring person (or any related person).

c. The trade or business conducted in this state by the acquiring person after the asset acquisition date shall be considered to be the same as an out-of-state trade or business conducted or previously conducted by the acquiring person (or any related person) only if the trade or business activities of both companies are or would be classified in the same division of the Manual.

d. An acquired trade or business will not be considered to have been acquired as an existing trade or business for purposes of this subsection if it is acquired either: (1) from a liquidation sale of assets pursuant to a bankruptcy filed under Chapter 7 of the United States Bankruptcy Code; or (2) pursuant to a creditor's execution or foreclosure sale of a secured interest in the assets of the trade or business.

e. Example No. 1: Corporation X is doing business wholly outside of this state in the trade or business of manufacturing automobiles. The total fair market value of the total assets of this trade or business is \$100,000,000. Then, on or after January 1, 1994, Corporation X acquires all of the assets of an automobile manufacturing business in this state with a fair market of \$5,000,000 and immediately uses the acquired assets in its automobile manufacturing trade or business. Thereafter, between the date of acquisition and the last day of the month following the

quarterly period during which the acquisition occurred, Corporation X acquires another \$1,000,000 in assets for use in the automobile manufacturing business in this state. Under these assumed facts, the conditions set forth in this subparagraph will not serve to disqualify Corporation X from the partial exemption since the fair market value of the acquired assets does not exceed 20 percent ($\$5,000,000/\$106,000,000$) of the aggregate fair market value of the total assets of the trade or business being conducted by Corporation X; and neither Corporation X nor any related person had conducted any trade or business activities in this state within the preceding 36 months.

f. Example No. 2: Assume the same facts as in Example No. 1 above, but in this case, prior to acquiring the assets of the automobile manufacturing business in this state, Corporation X was solely and exclusively in the trade or business of providing data processing services. After the acquisition of the assets by Corporation X, however, the acquired assets will continue to be used in the automobile manufacturing business in this state. Assume further that no additional purchases are made after the date of acquisition. Under these assumed facts, since data processing services and automobile manufacturing are classified in different divisions of the Manual, the partial exemption will not be available to Corporation X because the fair market value of the acquired assets exceeds 20 percent ($\$5,000,000/\$5,000,000$) of the aggregate fair market value of the total assets held by Corporation X in the same trade or business.

7. In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the person as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business. For purposes of this subsection only:

a. Example No. 1: Corporation X is doing business in this state. One of its trade or business activities in this state is manufacturing automobiles. After January 1, 1994, for consideration, Corporation X transfers all of the assets used in the trade or business of manufacturing automobiles to a newly-formed, wholly-owned subsidiary known as Corporation Y. For purposes of applying this regulation, this transaction shall be treated as an acquisition of an existing trade or business by Corporation Y.

b. Example No. 2: Partnership A is a manufacturer doing business in this state. After January 1, 1994, for consideration, Partnership A transfers all of its assets to a newly-formed corporation known as Corporation B. Corporation B is owned by the partners of Partnership A in the same proportionate ownership interests as their respective ownership interests in the partnership. For purposes of applying this regulation, this transaction shall be treated as an acquisition of an existing trade or business by Corporation B.

8. For purposes of this subsection, a person is a "related person" if that person is or previously was related to the qualified person within the meaning of either section 267 or 318 of the Internal Revenue Code.

9. The term "acquire" shall include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(B) A qualified person must be engaged in those manufacturing lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition. For purposes of this subsection:

1. For purposes of classifying a line or lines of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production. The term "establishment" means an economic unit, generally at a single physical location, where business is conducted or where services or manufacturing or other industrial operations are performed. The following will generally constitute an "establishment": a factory, mill, store, hotel, movie theater, mine, farm, ranch, bank, railroad depot, airline terminal, sales office, warehouse, or central administrative office.

2. For purposes of determining the "establishment" or "establishments" of a trade or business:

a. Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting. For purposes of this paragraph, whether or not employment in an economic activity is significant shall be based upon all of the facts and circumstances. Nevertheless, employment in an economic activity will be considered to be "significant" for purposes of this paragraph whenever more than 25 percent of the taxpayer's total number of employees at a single physical location, or more than 25 percent of the taxpayer's total dollar value of payroll at a single physical location, is attributable to the economic activity being tested for separate establishment status.

b. An establishment is not necessarily identical with the enterprise or company which may consist of one or more establishments. Also, an establishment is to be distinguished from subunits of the establishment such as departments.

c. Where a person conducts business at more than one establishment within the meaning of this subsection, then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in those lines of business that are described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.

(7) "Refining" means the process of converting a natural resource to an intermediate or finished product.

(8) "Research and development" means those activities that are described in section 174 of the Internal Revenue Code or in any regulations thereunder.

(9) "Tangible personal property" does not include any of the following:

(A) Real property, including tangible personal property to be incorporated into an improvement to real property, except for "special purpose buildings and foundations" as defined in subsection (c)(10)(D) and conveyance systems and assembly lines as provided in subsection (c)(10)(A).

(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E). Tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation.

(C) Furniture, inventory, equipment used in the extraction process, equipment used to store raw materials that have not yet entered or commenced the manufacturing process, or equipment used to store finished products that have completed the manufacturing process. The extraction process includes such severance activities as mining, oil and gas extraction.

(D) Any property for which a credit is claimed under either section 17053.49 or 23649 of the Revenue and Taxation Code.

(10) "Tangible personal property" includes but is not limited to the following:

(A) Machinery and equipment within the meaning of subsection (a)(6) of Regulation 1521 of the Sales and Use Tax Regulations, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. The term also includes conveyance systems and assembly lines without regard to the manner of affixation to real property.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall have a useful life of less than one year for purposes of this regulation.

(C) Property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state.

(D) Special purpose buildings and foundations that (i) are used as an integral part of the manufacturing, processing, refining, or fabricating process, or (ii) constitute a research facility used during the manufacturing process as an integral part of a manufacturing, processing, refining, or fabricating activity, or (iii) constitute a storage facility used during the manufacturing process as an integral part of a manufacturing, processing, refining, or fabricating activity. For purposes of this subsection:

1. For purposes of this subsection, "special purpose building and foundation" means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subsection (a)(1) of this regulation (the qualified purpose).

2. A building is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building for the intended purpose and then use the structure for a different purpose.

3. A building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

4. In the event an entire building does not qualify as a special purpose building, a taxpayer may establish that a portion of a building, and the foundation immediately underlying the portion, qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subsection.

5. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process.

6. For purposes of this subsection, the term "integral part" means that the special purpose building or foundation (i) is used directly in the activity qualifying for the partial exemption from sales and use tax and (ii) is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(E) Fuels used or consumed in the manufacturing process.

(F) Property used in recycling.

(11) "Standard Industrial Classification" means a Standard Industrial Classification in the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.

(d) Three-Year Limitation. Notwithstanding any other provision of this regulation, once a person has conducted business activities in a new trade or business for three or more years, that person will no longer be considered to be in a "new trade or business," nor "qualified" for this partial exemption.

(e) Taxes as to Which the Partial Exemption Does Not Apply. This partial exemption does not apply to any tax levied by a county, city, or district pursuant to, or in accordance with, either the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200 et seq.) or the Transactions and Use Tax Law (Rev. & Tax Code §§ 7251 et seq.).

On or after January 1, 1995, this partial exemption shall not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution.

(f) Exemption Certificates. Except as otherwise set forth in subsection (f)(3), to claim the partial exemption provided by this regulation, a person must be both pre-qualified by the Board and either registered to hold a seller's permit or maintain a consumer use tax account. Exemption certificates issued to qualified persons will contain a control number and expiration date for verifying a person's status as a qualified person. An exemption certificate is not valid if it has not been issued by the Board or if it is accepted after the expiration date on the certificate. Qualified persons who have been pre-qualified may reproduce the issued certificates as needed for their qualifying purchases.

The exemption certificates issued by the Board will be in substantially the same form as they appear in Appendices A and B of this regulation. Qualified persons who purchase or lease tangible personal property from an in-state retailer or an out-of-state retailer obligated to collect the use tax must provide the retailer with a manufacturer's exemption certificate in order to claim the partial exemption. The manufacturer's use tax declaration must be completed by a qualified person to claim a partial exemption from use tax on purchases of tangible personal property from an out-of-state retailer not obligated to collect the use tax.

(1) Manufacturer's Exemption Certificates.

(A) In General. Except as otherwise provided in subsections (f)(1)(B) or (f)(3) of this regulation, or in section 6902.2 of the Revenue and Taxation Code, a partial exemption from sales or use tax shall not be allowed unless:

1. The qualified person furnishes the retailer with a manufacturer's exemption certificate no later than 60 days after the date of the purchase; and

2. The retailer timely files a sales and use tax return claiming the partial exemption and, together with that timely return, provides the Board with a copy of the manufacturer's exemption certificate.

(B) Exclusions. Except as provided in subsection (f)(1)(C) below, retailers claiming the partial exemption in timely filed returns will not be required to furnish the Board with copies of manufacturer's exemption certificates for sales or leases of tangible personal property made by a retailer at any single physical location to a single qualified purchaser that do not exceed an

aggregate total of \$25,000 during a single calendar quarter. Regardless of the total quarterly sales per purchaser, however, when necessary for the efficient administration of the sales and use tax law, the Board may, on 30 days' written notice, require a retailer to commence furnishing the Board with copies of all certificates on a quarterly basis pursuant to subsection (f)(1)(A)2.

(C) **Retention And Availability Of Certificates.** A retailer must retain each manufacturer's exemption certificate received from a qualified person for a period of four years from the date on which the retailer claims a partial exemption based on the exemption certificate.

Within 45 days of the Board's request, retailers must furnish to the Board any and all manufacturer's exemption certificates, or copies thereof, received from qualified persons, including exemption certificates for aggregate sales or leases of \$25,000 or less to a single qualified person made at any single physical location of the retailer during a single calendar quarter.

(2) **Manufacturer's Use Tax Declaration.** Except as provided in section 6902.2 of the Revenue and Taxation Code, a partial exemption from the use tax shall not be allowed unless the qualified person:

(A) Timely files a sales and use tax return or consumer use tax return for the period in which the purchase occurs and timely pays any applicable tax in full that is excluded from this partial exemption as provided in subsection (e) of this regulation; and

(B) Attaches a completed manufacturer's use tax declaration to the sales and use tax return or consumer use tax return that is timely filed with the Board.

(3) ~~Waiver-Refund of Partial Exemption.—Except as specifically set forth in section 6902.2 of the Revenue and Taxation Code:~~

~~—(A) Failure to claim the partial exemption by furnishing the retailer with a manufacturer's exemption certificate within 60 days after an otherwise qualified purchase constitutes a waiver of the partial exemption for that purchase and, as a consequence, the partial exemption cannot be claimed on that purchase.~~

~~—(B) Failure to file a timely return for an otherwise qualified purchase from a retailer not engaged in business in this state, or failure to attach a completed manufacturer's declaration to such a timely filed return, does not constitute a waiver of the use tax partial exemption for that purchase. A person who fails to file a timely return or attach a completed manufacturer's declaration to a timely return for an otherwise qualified purchase has the burden of establishing that he or she was entitled to claim the partial exemption.~~

(A) For the period commencing on January 1, 1994, and ending on December 31, 1994, a qualified person may claim the partial exemption on qualified purchases from an in-state retailer or an out-of-state retailer obligated to collect the use tax by furnishing the retailer with a manufacturer's exemption certificate on or before March 31, 1995. The retailer must refund the tax directly to the purchaser or, at the purchaser's sole option, the purchaser may be credited with such amount. In the event that the retailer has already reported and paid the tax to the Board, the retailer must file a written claim for refund on or before April 30, 1995.

(~~CB~~) A person who ~~self-reported and paid sales or use tax on a qualified purchase from a retailer not engaged in business in this state, and who failed to claim the partial use-tax exemption as provided by this regulation may file a claim for refund equal to the amount of the partial exemption that he or she could have claimed pursuant to this regulation. The procedure for such a claim shall be the same as for other claims for refund filed pursuant to Revenue and Taxation Code section 6901. A person filing a claim for refund of the partial-use-tax exemption has the burden of establishing that he or she was entitled to claim the partial exemption with respect to the amount of refund claimed under this part.~~

(4) Construction Contractors. In the case of a contractor who purchases property as an agent of a qualified person or for subsequent resale to a qualified person, the qualified person is deemed to be the purchaser for purposes of this subsection.

(g) Conversion of Property to a Use Not Qualifying for the Partial Exemption. Notwithstanding subsection (a), this partial exemption shall not apply to any sale of, or the storage, use, or other consumption in this state of property that, within one year from the later of the date of purchase of the property or the date that the property was first placed into service by the purchaser in an exempt use, is: (i) removed from this state, (ii) converted from an exempt use under this regulation to some other use not qualifying for the partial exemption, or (iii) used in a manner not qualifying for the partial exemption under this regulation. For purposes of this subsection, property is converted to a use not qualifying for the partial exemption if, without limitation, the property, or any interest in the property, or possession or control of the property, is either directly or indirectly sold, transferred, leased, or assigned to a person who is not a qualified person on the date the property is sold, transferred, leased, or assigned to such nonqualified person. In the case of a corporation that, as a qualified person, purchases tangible personal property under this partial exemption and then, within one year from the later of the date of purchase of the property or the date that the property was first placed into service by that corporation in an exempt use, either directly or indirectly transfers that property to its parent corporation that is not a qualified person on the date of the transfer of property to the parent corporation, that property has been converted to a use not qualifying for the partial exemption.

(h) Purchaser's Liability for the Payment of Sales Tax. If a purchaser submits a copy of a manufacturer's exemption certificate to the seller, and then within one year from the later of the date of purchase of the property or the date that the property was first placed into service by the purchaser in an exempt use, the purchaser either (i) removes that property from this state, (ii) converts that property from an exempt use under this regulation to some other use not qualifying for the partial exemption, or (iii) uses that property in a manner not qualifying for the partial exemption under this regulation, then, in that event, the purchaser shall be liable for payment of sales tax, with applicable interest, to the same extent as if the purchaser were a retailer making a retail sale of the property at the time the property was so removed, converted, or used; and the sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale. For purposes of this subsection, property is converted to a use not qualifying for the partial exemption if, without limitation, the property, or any interest in the property, or possession or control of the property, is either directly or indirectly sold, transferred, leased, or assigned to a person who is not a qualified person on the date the property is sold, transferred, leased, or assigned to such nonqualified person.

(i) Leases to Qualifying Persons.

(1) Leases--In General. Subject to all the limitations and conditions set forth in this regulation and regulation 1525.3, this partial exemption may apply to rental receipts paid by a qualified person with respect to a lease of tangible personal property to the qualified person, which tangible personal property is used as set forth in subsections (a)(1), (a)(2), (a)(3), or (a)(4) of this regulation.

(2) Leases--Acquisition Sale and Leaseback. A person will be regarded as having paid sales tax reimbursement or use tax with respect to that person's purchase of property, within the meaning of those words as they are used in section 6010.65 of the Revenue and Taxation Code, if the person has paid all applicable taxes with respect to the acquisition of the property, notwithstanding the fact that the sale and purchase of the property may have been subject to the partial exemption from tax provided by this regulation.

(3) Subsequent Lease of Property Acquired Subject to Partial Exemption. If a person has acquired property subject to the partial exemption provided by this regulation and has paid all applicable taxes at that acquisition, the property will be regarded as property as to which sales tax reimbursement or use tax has been paid, and the subsequent lease of that property will not be subject to tax measured by rental receipts.

(j) Effective Date. Except as expressly set forth otherwise in subsections (c)(6)(A)6. and (e) of this regulation, this regulation is effective as of January 1, 1994.

History: Adopted February 9, 1995, effective August 18, 1995.

Amended November 7, 1997, effective December 7, 1997. Added new subdivision (c)(4) to incorporate provisions of Chapter 954, Statutes of 1996 and renumbered the following subdivisions. Subdivision (I)(1) was amended to add reference to Regulation 1525.3 and Appendix A & B were updated for clarity.

Amended December 8, 1998, effective April 3, 1999. Subdivision (f): phrase "Except ... (f)(3)," added to first sentence. Subdivision (f)(3)(B): phrase "does not" added and phrase "and ... purchase" deleted; last sentence added. New subdivision (f)(3)(C) added.

SECTION 6377 MANUFACTURER'S EXEMPTION CERTIFICATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

PLEASE NOTE

This is a partial exemption from sales and use tax at the rate of 5% effective January 1, 1995. You are not relieved from your obligations for the local and district taxes on this transaction. The exemption is specific to this transaction only and may not be construed to exempt other transactions. Generally, the partial exemption will not be allowed unless this certificate is issued within 60 days after the date of purchase and the retailer claims the exemption on a timely filed return. Void after expiration date.

Certificate No:

Expires:

I hereby certify that the tangible personal property described below and purchased or leased from: (enter seller's/lessor's name and address)

SELLER'S NAME

SELLER'S ADDRESS (Street, City, State, Zip Code)

and will be used by me primarily (please check one)

1. for manufacturing, processing, refining, fabricating, or recycling, or
2. for research and development activities as described in Internal Revenue Code Section 174, or
3. to maintain, repair, measure, or test any property being used for (1) or (2) above, at my facility located at (enter facility's address):

(Street, City, State, Zip Code)

CERTIFICATE NOT VALID FOR PURCHASES WITH A UNIT VALUE OF \$250.00 OR LESS

SALES INVOICE NUMBER	SALES INVOICE DATE	DESCRIPTION OF QUALIFIED PROPERTY PURCHASED OR LEASED*	SALES PRICE/ RENTALS PAYABLE

I understand that if such property is, within one year from the date of purchase or lease, removed from California or converted for use or otherwise used in a manner not qualifying for the exemption that I am required by the Sales and Use Tax Law to report and pay the state tax measured by the sales price/rentals payable of the property to/by me. *Attach a copy of the lease agreement.

PRINT NAME	TITLE	
SIGNATURE	DATE	PERMIT NUMBER

NOT VALID UNLESS COMPLETED BY THE CALIFORNIA STATE BOARD OF EQUALIZATION

The following business has been registered as a "qualified person" who has certified that this purchase/lease of tangible personal property will be used in a manner entitling them to the exemption provided in Section 6377 of the Revenue and Taxation Code.

BUSINESS NAME	SIC CODE	
BUSINESS ADDRESS (Street, City, State, Zip Code)		PERMIT NUMBER

AUTHORIZED BY (Must Have Two Signatures)

REVIEWED BY	DATE
APPROVED BY	DATE

PLEASE NOTE

This exemption being declared applies only to the state use tax which is at the rate of 5% effective January 1, 1995 and is specific to this transaction only and may not be construed to exempt other transactions. As the purchaser, you remain liable for the applicable local and district taxes. To claim the exemption, this declaration must accompany a timely filed sales and use tax.

Certificate No:

Expires:

I hereby certify that the tangible personal property described below that is subject to use tax was purchased or is being leased from: (enter seller's/lessor's name and address)

SELLER'S NAME

SELLER'S ADDRESS (Street, City, State, Zip Code)

and will be used by me primarily (please check one)

1. for manufacturing, processing, refining, fabricating, or recycling, or
2. for research and development activities as described in Internal Revenue Code Section 174, or
3. to maintain, repair, measure, or test any property being used for (1) or (2) above, at my facility located at (enter facility's

address):

(Street, City, State, Zip Code)

CERTIFICATE NOT VALID FOR PURCHASES WITH A UNIT VALUE OF \$250.00 OR LESS.

SALES INVOICE NUMBER	SALES INVOICE DATE	DESCRIPTION OF PROPERTY PURCHASED OR LEASED*	SALES PRICE/ RENTALS PAYABLE

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BUSINESS NAME	SIC CODE	
BUSINESS ADDRESS (Street, City, State, Zip Code)	PERMIT NUMBER	

AUTHORIZED BY (Must Have Two Signatures):

REVIEWED BY	DATE
APPROVED BY	DATE

THIS FORM MAY BE REPRODUCED

Appendix B